



**SHRIVER
CENTER**

Sargent Shriver National Center on Poverty Law

March 22, 2010
Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Comments on Notice of Proposed Rulemaking Credit Card Accountability, Responsibility and Disclosures Act of 2009, 75 Fed. Reg. 12, 334 (March 15, 2010), Regulation Z - Truth in Lending (R-1384)

Dear Chairman Bernanke, Members of the Board, and Board Secretary Johnson:

I am writing from the Sargent Shriver National Center on Poverty Law ("Shriver Center"), a Chicago -based non-profit policy development and advocacy organization, to comment on the proposed changes to Regulation Z - Truth in Lending (R-1384), which would create new rules to regulate the credit card industry pursuant to the Credit Card Accountability, Responsibility and Disclosures Act of 2009 ("Credit CARD Act").

We commend the Federal Reserve for its efforts in issuing the proposed rule as an important step in providing needed consumer protections in financial products and services. In general, we support many of the provisions; there are, however, a number of ways in which the proposed rule can be improved as set forth below.

I. Section 226.7 Periodic Statement

The Board proposes to amend Section 226.7(b)(11)(i)(B) to clarify that it is no longer optional to state that the late payment fee may be lower than the disclosed amount. A card issuer is, however, permitted to disclose a range of late payment fees if, for example, the issuer chose not to impose a fee when a required minimum periodic payment below a certain amount is not received by the payment due date.

Comment: *The newly proposed Section appears to strike the correct balance between providing necessary and relevant disclosures versus excessive disclosures. Yet, those consumers that desire to know the precise late fee amount that they will be assessed should have such information available in the cardholder agreement and/or on the card issuer's website.*

II. Section 226.9, Subsequent Disclosure Requirements: Section 226.9(c), Change in Terms; Section 226.9(c)(2), Rules Affecting Open-End (Not Home Secured) Plans and Section 226.9(g), Increases in Rates Due to Delinquency or Default or as a Penalty

Section 226.9(g) addresses increases in rates due to delinquency or default or as a penalty. The Credit Card Act requires creditors that increase an annual percentage rate applicable to a credit card account under an open-end (not home secured) consumer credit plan, to consider factors such as the credit risk of the consumer, market conditions, and other factors, when subsequently determining whether to reduce the annual percentage rate. Specifically creditors are required to review, no less frequently than once every 6 months, accounts whose annual percentage rate has been increased to assess whether these any of these factors have changed. If, after a review, a rate reduction is indicated, then the credit issuer must make such reduction, however, no specific amount of reduction in the rate is required. Credit card issuers must review accounts on which the annual percentage rate has been increased since January 1, 2009. The Board is proposing to implement these substantive requirements in a new Section, Section 226.59, as discussed later in this letter.

Comment: *See comments on Section 226.59 discussed below.*

The Credit Card Act also requires creditors to disclose the reasons for an annual percentage rate increase applicable to a credit card in the notice required to be provided 45 days in advance of such increase. A proposed new Section 226.9(c)(2)(iv)(A)(8) would require that a card issuer disclose no more than 4 principle reasons for the rate increase for a credit card account, listed in their order of importance, in the required notice. The Board believes that a maximum of 4 reasons would avoid information overload, and that it is not necessary for the Board to mandate the minimum number of reasons. Similarly, a proposed new Section 226.9(g)(3)(i)(A)(6) would explain that for rate increases due to delinquency, default, or as a penalty not due to a change in contractual terms of the consumer's account a card issuer must disclose no more than 4 reasons for the rate increase, listed in order of importance, for a credit card account.

Comment: *While we understand the Board's concern that too much information will be overwhelming, we are concerned that there may not be enough disclosure or transparency under the proposed rules. Specifically, limiting the number of reasons that must be disclosed to 4 is appropriate, provided that a consumer may contact the card issuer or view their account information online for a list of all of the reasons for any changes, whether it is an annual percentage rate increase or an increase due to delinquency, default or a penalty.*

The Board also states that a card issuer may describe the reasons for the increase in general terms.

Comment: *The Board again appears to be concerned about information overload and the efficiency and burden of making disclosures. It would be appropriate to disclose the reasons for any changes in general terms (e.g., a "decline in credit score" rather than "a*

decrease in your credit score by 100 points”), provided that a consumer may contact the card issuer or view their account information online for specific details of the reasons for the change. Ensuring access to all of the information that a card issuer bases any changes on will provide a transparency that has been lacking in the credit card industry. Consumers need to know the data used by credit card issuers so that they may make appropriate choices in their use of credit.

III. Section 226.52 Limitations on Fees

A. Section 226.52(b), Limitations on Penalty Fees

Credit card agreements often state that a fee will be assessed if the amounts charged to the account exceed the account's credit limit. The Credit Card Act requires that the amount of any penalty fee or charge that a card issuer imposes in connection with any omission or violation of the cardholder agreement, including any late payment, over-the-limit fee, or any other penalty fee or charge, must be reasonable and proportional to such omission or violation. In establishing the rules related to this section the Board was required to consider: (1) the cost incurred by the creditor from such omission or violation, (2) the deterrence of such omission or violation by the cardholder, (3) the conduct of the cardholder, and (4) such other factors as the Board may deem necessary or appropriate. Additionally, the Board's authority allows it to establish different standards for different types of fees and charges and to designate an amount for any penalty fee or charge that is presumed to be reasonable and proportional to the omission or violation to which the fee or charge relates.

With respect to costs incurred as a result of violations, the Board concluded that the dollar amount of a penalty fee is reasonable and proportional if it represents a reasonable proportion of the total costs incurred by the issuer as a result of that type of violation across all consumers. With respect to deterrence of violations, the Board concluded that a penalty fee is reasonable and proportional to a violation if the dollar amount of the fee is reasonably necessary in order to deter that type of violation. With respect to consumer conduct, the Board recognized that consideration of individual consumer conduct is not feasible and penalty fees should not be based exclusively on consumer conduct and instead credit card issuers should be prohibited from imposing penalty fees that exceed the dollar amount associated with the violation.

The Board also proposed safe harbors amounts for each of these situations that would be presumed to be reasonable and proportionate to a card issuers costs, to deter violations and to permit higher penalty fees when a large dollar amount is associated with the violation. Specifically, issuers would be permitted to impose penalty fees up to 5% of the dollar amount associated with the violation up to certain maximum amount. The Board's proposed rule would also prohibit issuers from imposing multiple penalty fees based on a single event or transaction.

Comment: *In addition to the factors described by the Board, factors such as including a debt to income ratio or an adjustment based on annual income, so annual credit card payments do not exceed 15% of gross annual income, should also be considered. Card issuers should be allowed to impose penalty fees in increments based on the*

consumer's conduct, however, the total penalty fee imposed should not exceed the maximum fee allowed by Board regulations.

B. Section 226.52(b)(1), General Rules

In order to determine such “reasonable and proportional standards” the Board considered the need for general regulations that can be consistently applied and the need for regulations to produce fees that can be effectively disclosed.

1. Proposed Section 226.52(b)(1)

Proposed Section 226.52(b)(1) would prohibit a card issuer from imposing a fee for violating the terms of a cardholder agreement unless the card issuer determined that either: (1) the dollar amount of the fee represents a reasonable proportion of the total costs incurred by the card issuer as a result of that type of violation, or (2) the dollar amount of the fee is reasonably necessary in order to deter that type of violation. Card issuers would be required to make these determinations with respect to the type of violation (for example, late payments), rather than a specific violation or an individual consumer.

The proposed comment on 52(b)-1 would clarify that a fee is any charge imposed by a card issuer based on an act or omission that violates the terms of the cardholder agreement other than charges attributable to periodic interest rates. This comment would provide examples of permissible fees subject to limitations and those not subject to limitations. In other words, according to the Board Congress did not intend the reasonable and proportional requirement to be applied to increases in annual percentage rates. As the Board explained, Congress expressly referred to increases in annual percentage rates when it intended to address them. Moreover, the Board believes that there are other protections available with respect to annual percentage increases: (i) prohibitions on applying penalty rates to existing credit card balances unless the account is more than 60 days late and requiring that the penalty rate must terminate if the required minimum payments are made on time for the next 6 months; (ii) prohibitions on card issuers from applying a penalty rate during the first year after account openings and providing 45 days advance notice before applying a penalty rate to new transactions; and (iii) once a penalty rate is in effect, requiring the card issuer to review the account at least once every 6 months and reduce the rate if appropriate.

Comment: *This proposed Section and comment could potentially create a loophole for credit card issuers to avoid the purpose of these regulations. Although card issuers must apply a “reasonable and proportional standard” to the amount of any penalty fees, issuers can simply recoup the amounts that they would have made from such penalty*

fees by increasing annual percentage rates without restrictions. Since the purpose of the Credit Card Act is to protect consumers from the excessive use of fees and random and substantial annual interest rate increases, without applying a reasonableness standard card issuers could, and will charge usurious interest rates. In such instances, consumer will be faced with the same types of high interest rates that payday lenders provide.

The proposed comment on 52(b)(1)-1 would clarify that an issuer will not satisfy the requirements for how to determine reasonableness and proportionality simply because a card issuer's fees for violating account terms are comparable to fees accessed by other card issuers. Instead, each card issuer must make its own determinations whether its fees represent a reasonable proportion of the total costs incurred by such issuer or are reasonably necessary to deter violations.

Comment: *We agree that each card issuer must make its own determination. Card issuers vary in size and efficiencies. Requiring them to potentially decrease their costs and overhead in order to match a competitor's penalty fee structure will increase competition and market efficiencies.*

(a) Section 226.52(b)(1)(i). Fees Based on Costs

The proposed comment on 52(b)(1)(i)-1 would clarify that a card issuer is not required to base its fees on the costs incurred as a result of a specific violation of a cardholder agreement. Instead, a card issuer should consider: (i) the number of violations of a particular type experienced by the card issuer during a prior period; and (ii) the costs incurred by the card issuer during that period as a result of those violations. Additionally, the card issuer may base its fees on a reasonable estimate of changes in the number of violations of that type and the resulting costs during an upcoming period.

Comment: *While we agree that it is not feasible for a card issuer to determine its penalty rates on a case-by-case basis, allowing an issuer to base such rates on future projections could be problematic. Specifically, issuers could exaggerate such estimates. Thus, it will be important for regulators to review the basis of such estimates.*

The proposed comment on 52(b)(1)(i)-2 would clarify that although higher rates of loss may be associated with particular violations of account terms, those losses and associated costs (such as the cost of holding reserves against losses) are excluded from the 226.52(b)(1)(i) cost analysis. As a general matter, card issuers currently do not price for the risk of loss through penalty fees, instead, they generally price for risk through upfront annual percentage rates and penalty rate increases. The Board is concerned that if card issuers were permitted to begin recovering

losses and associated costs through penalty fees rather than upfront rates
- transparency in credit card pricing would be reduced.

Comment: *We agree with the Board that permitting card issuers to include losses and associated costs in determining penalty fees could result in double billing. The consumer would pay for the risks of such violations in upfront fees and interest rates, as well as through penalty fees after a violation.*

The proposed comment 52(b)(1)(i)-3 would clarify that costs incurred by a card issuer from a third party as a result of a violation of the account terms is considered part of the costs incurred by the card issuer due to a violation. If, however, the third party is an affiliate or subsidiary of the card issuer, the card issuer must ensure that the amount charged represents a reasonable proportion of the costs incurred by the affiliate or subsidiary as a result of the type of violation.

Comment: *We agree with this proposed comment.*

The proposed comment to 52(b)(1)(i)-4 would clarify that the costs incurred by a card issuer as a result of late payments include the costs associated with the collection of late payments, such as the costs associated with notifying consumers of delinquencies and resolving delinquencies.

Comment: *We agree with this proposed comment.*

The proposed comment 52(b)(1)(i)-5 would clarify that costs incurred by a card issuer as a result of returned payments include the costs associated with processing returned payments and reconciling the card issuer's systems and accounts to reflect returned payments, as well as the costs associated with notifying the consumer of the returned payment and arranging for a new payment.

Comment: *We agree with this proposed comment.*

The proposed comment 52(b)(1)(i)-6 would clarify that costs incurred by a card issuer as a result of over-the-limit transactions include the costs associated with determining whether to authorize over-the-limit transactions and the costs associated with notifying the consumer that the credit limit has been exceeded and arranging for payments to reduce the balance below the credit limit.

Comment: *We agree with this proposed comment.*

(b) Section, 226.52(b)(1)(ii), Fees Based on Deterrence

The proposed comment 52(b)(1)(ii)-1 would clarify that a card issuer is not required to base its determination of fees necessary to deter violations based on a specific consumer. Instead, a card issuer only has to determine that a fee is reasonably necessary to deter the type of violation for which the fee is imposed.

Comment: *We agree with this proposed comment.*

The proposed comment 52(b)(1)(ii)-2 clarifies that an issuer only has to determine that the dollar amount of the fee is reasonably necessary to deter violations. To support such a finding an issuer must use a model that reasonably estimates that, independent of other variables, the imposition of a lower fee amount would result in a substantial increase in the frequency of that type of violation.

Comment: *We agree with this proposed comment.*

The Board notes that card issuers will need to test the effectiveness of fee amounts that are lower and higher than the amount ultimately found to be reasonably necessary to deter a type of violation. According to the Board, some card holders may be able to gather this data by testing the deterrent effects of different fee amounts prior to the deadline, but that issuers who cannot do so are required to base their penalty fees on the reasonable and proportional costs incurred by the issuer as a result of a violation of that type, or to use the proposed safe harbor.

Comment: *We do not believe that it is appropriate for cardholders to test the deterrence effects of different fee structures on consumers. First, there are other mechanisms available to card issuers, such as research studies and surveys, to obtain this information. Second, and perhaps most important, consumers have already paid high fees to card issuers that were not based on any kind of relationship to the amount of the violation, cost to the issuer or deterrence effect. To have consumers pay again for card issuers to determine the appropriate level of fees is unfair. Instead, card issuers should use the billions that they have collected from their previous overrated fees for research studies or surveys. Finally, the Board has acknowledged in its comments that penalty fees have increased significantly over the past 15 years and that 10% of issuers' revenues are generated by such fees. The Board also pointed out the fact that fees charged by larger card issuers are much higher than those charged by small issuers which suggests that these penalty fees are higher than actual*

costs. Thus, issuers should not be allowed to continue to profit from or experiment on consumers through their fee structures. In the event that such testing is permitted, limitations are necessary to ensure that such testing is legitimate and does not harm cardholders. For example, issuers should be restricted from profiting from the testing process. This could be accomplished by limiting the duration of the testing period and returning to the consumer any portion of fees that exceed the amounts otherwise permitted by Section 226.52(b)(1).

(c) Section 226.52(b)(1)(iii), Reevaluation of Fees

The **proposed Section 226.52(b)(1)(iii)** would require a card issuer to reevaluate its determination of fees based on costs and fees based on deterrence at least once every 12 months. Additionally, if such reevaluation reveals that a lower fee is appropriate the card issuer must begin imposing the lower fee within 30 days after completing the reevaluation. Alternatively, if the evaluation reveals that a higher fee is appropriate the card issuer may begin imposing the higher fee after providing 45 days advance notice to the consumer.

Comment: *We believe that a more appropriate timeframe for such reviews is 6 months. First, card issuers will already be examining accounts every 6 months to determine whether or not a penalty fee should be removed. They can just as easily review their formulas for determining deterrence costs at the same time. Second, market conditions change rapidly and consumer's reactions also change rapidly. Card issuers react just as rapidly when market conditions worsen and default risks are higher. They should be required to react just as rapidly when economic conditions improve and default risks decrease. Finally, reevaluating risks more frequently will increase competition in the marketplace as issuers strive to react swiftly to the economy and consumers' behaviors.*

C. Section 226.52(b)(2), Prohibited Fees

Proposed new Section 226.52(b)(2) would prohibit credit card penalty fees that the Board believes to be inconsistent with the new Credit Card Act.

1. Fees that Exceed Dollar Amount Associated with Violation

The **proposed new section 226.52(b)(2)(i)(A)** would prohibit an issuer from charging penalty fees greater than the dollar amount associated with the violation. As the Board notes, Congress did not intend to permit a \$35 over-the-limit fee for a \$5 overdraft. The Board also acknowledges that such fees do not appear to be proportional to the consumer conduct that created the violation.

The Board states that such limitations may encourage card issuers to either reduce the costs incurred as a result of violations that involve small dollar amounts or to incorporate these costs into their upfront rates and fees, which will result in greater transparency for consumers regarding the cost of using credit cards.

Comment: *We agree with this provision. As the Board correctly notes the compliance burden issuers will incur will be limited. Card issuers will be able to comply with this requirement through a simple electronic programming modification to their existing systems.*

The proposed comment provides guidance on the dollar amount related to specific violations of account terms. The Board clarifies that the dollar amount is associated with a violation resulting from customer conduct.

Comment: *Although the Board has clarified this issue additional guidance is also needed with respect to the dollar amounts associated with other types of violations.*

(a) Dollar Amount Associated with Late Payments

The proposed comment 52(b)(2)(i)-1 would clarify that a card issuer cannot impose a late payment fee greater than the amount of the required minimum periodic payment on which that fee is based.

Comment: *We agree with this comment.*

(b) Dollar Amount Associated with Returned Payments

The proposed comment 52(b)(2)(i)-2 would clarify that a card issuer cannot charge a returned payment fee that exceeds the amount of the required minimum periodic payment.

Comment: *We agree with this comment.*

Proposed comment 52(b)(2)(i)-2 would also clarify that if a payment that has been returned is resubmitted and rejected a second time the card issuer cannot charge a separate or additional dollar amount for the subsequent return of that payment.

Comment: *We agree with this comment. In particular, we believe the Board's analysis is correct that the resubmission does not involve any action by the consumer and, therefore, they should not be penalized a second time. Previously, card issuers have used tactics such as multiple resubmissions as a means of generating revenue. This proposed comment would make it clear that such conduct is no longer acceptable.*

(c) Dollar Amount Associated with Extensions of Credit in Excess of Credit Limit

The proposed comment 52(b)(2)(i)-3 would clarify that the dollar amount associated with an overdraft is the total amount of credit extended by the card issuer in excess of the consumer's credit limit as of the date on which the over-the-limit fee is imposed. The comment would further clarify that although a card issuer is prohibited from imposing more than one over-the-limit fee per billing cycle, the card issuer may choose the date during the billing cycle on which to impose an over-the-limit fee.

***Comment:** We disagree with permitting the card issuer to determine the date on which to impose an over-the-limit fee. As shown in the example given by the Board for this Section, by manipulating the date an issuer can maximize fees. Moreover, a consumer will be unaware of when a fee has been actually assessed. Instead, the issuer should be required to establish a fixed date that is previously disclosed to the consumer.*

(d) Dollar Amounts Associated with Other Types of Violations

The proposed new Section 226.52(b)(2)(i)(B) would prohibit the imposition of penalty fees in circumstances where there is no dollar amount associated with the violation. In particular, this Section would specifically prohibit a card issuer from imposing a fee based on a transaction that the issuer declines to authorize. The Board points out that unlike an over-the-limit transaction, a declined transaction does not result in an extension of credit and there is no dollar amount associated with a declined transaction. Similarly, the Board points out that unlike returned payments a card issuer does not incur costs for reconciling its system or arranging for a new payment when a transaction is declined.

***Comment:** We agree with this proposed Section. In particular, we agree that allowing a card issuer to charge for declined transactions is inappropriate and would defeat the purpose of requiring opt-in for overdraft coverage. A consumer elects not to participate in overdraft protection because they want a transaction denied when they have insufficient funds. They do not want this extension of additional credit, nor do they want to pay a fee for it. Moreover, when they have opted-out of overdraft coverage they do not expect to have a fee imposed. Such a fee would, in effect, penalize them for their sound financial decision not to overspend.*

Proposed 226.52(b)(2)(i)(B) would also specifically prohibit a card issuer from imposing a penalty fee based on account inactivity or the closure or

termination of an account. However because card issuers incur these costs with respect to all accounts, the Board does not believe that they constitute a dollar amount associated with a violation.

Comment: *We agree with this comment. The cost associated with administering inactive accounts is minimal. Moreover, inactivity does not constitute any sort of violation of a card holder agreement. Instead, allowing such fees would encourage card issuers to use them as revenue generating tools.*

2. Multiple Fees Based on A Single Transaction

Proposed Section 226.52(b)(2)(ii) would prohibit card issuers from imposing more than one penalty fee based on a single event or transaction. Issuers would, however, be permitted to comply with this requirement by imposing no more than one penalty fee during a billing cycle. The Board notes that a card issuer may incur greater costs as a result of an event or transaction that causes multiple violations, but that an issuer can recover those costs by spreading them evenly among all other consumers whose payments are returned.

Comment: *We agree that a card issuer should not be charged multiple fees based on one event or transaction, however, we are concerned about the Board's statement that an issuer could recover its costs by spreading them evenly among all other consumers whose payments are returned. It should be emphasized that the calculation of such costs must be reasonable and proportional to the issuer's actual costs.*

Section 226.52(b)(2)(ii) would permit a card issuer to avoid the burden associated with determining whether multiple violations occurred by charging no more than one penalty fee per billing cycle. The Board believes that this approach will provide at least the same degree of protection for consumers as prohibiting multiple fees based on a single event or transaction because fees imposed in different billing cycles are typically caused by different events or transactions.

Comment: *We agree with this comment.*

D. 52(b)(3), Safe Harbor

The Credit Card Act authorizes the Board to establish penalty fees that are presumed to be reasonable and proportional to the violation. According to the Board establishing a generally applicable safe harbor will facilitate compliance and increase consistency and predictability for consumers. However, the Board does not have sufficient information to determine the appropriate amount at this time.

Comment: *Although we agree in principle with the idea of having a safe harbor, we are uncertain of the effect this will have on consumers until the amount is*

determined. The specific dollar amount cap should be kept low in order to protect consumers and discourage card issuers from manipulating penalties and fees to maximize profits. We therefore suggest that the Board publish a proposed rule stating the amount of the safe harbor and explaining the formula for determining it so that the public may make an informed comment.

1. Information Considered by the Board

In determining the amount of the proposed safe harbor, the Board considered the dollar amounts of penalty fees currently charged by card issuers. The Board noted that although credit card penalty fees are approximately \$32 to \$37 on average, many smaller card issuers (such as community banks and credit unions) charge penalty fees of approximately \$20. According to the Board this discrepancy between fees suggests that although violations of the account terms likely impact different types of card issuers to different degrees, fees that are substantially lower than the current average may be sufficient to cover an issuer's costs.

Comment: *We agree with this comment. The Board correctly notes that penalty fees charged by large card issuers are significantly higher than those charged by smaller issuers. It would be expected to be the opposite since larger issuers can theoretically leverage the volume of their accounts to create efficiencies that smaller credit card issuers cannot. The fact that it is the larger issuers charging higher fees undermines the argument that such fees are reasonable and proportionate to the issuers' actual costs.*

The Board also considered the amounts of penalty fees charged for deposit accounts and other consumer credit accounts. These fees were also significantly lower than average credit card penalty fees, indicating that lower credit card penalty fees may adequately reflect an issuer's cost and deter future violations.

Comment: *We agree with this comment.*

Third, the Board considered state and local laws regulating penalty fees which are significantly lower than the current average for credit card penalty fees. The Board also noted that some state and local laws governing late payment fees for utilities permit only fixed fee amounts, while others limit the fee to a percentage of the amount past due or some combination of the two.

Fourth, the Board noted that the United Kingdom's safe harbor thresholds for credit card default charges are open to challenge on grounds of unfairness if they have the object of raising more in revenue than is reasonably expected to be necessary to recover certain limited administrative costs incurred by the credit card issuer.

Comment: *We agree with this comment. We encourage the Board to consider this policy of allowing challenges to unfair rates as it implements these regulations. In particular, we hope that the Board will challenge card issuers if their fees appear exorbitant or unfair.*

2. Proposed Safe Harbor

Proposed Section 226.52(b)(3) would create a safe harbor for a credit card issuer if their fees were limited to the greater of (1) a specific dollar amount or (2) 5% of the dollar amount associated with the violation up to a specific maximum dollar amount.

Comment: *Although we agree in principle with the idea of having a safe harbor structured this way, we are uncertain of the effect this will have on consumers until the amount is determined and the percentage tested. We therefore suggest that the Board publish a proposed rule stating the amount of the safe harbor and explaining the formula for determining it, as well as an explanation for why the percentage is appropriate. This will allow the public to make informed comments.*

Section 226.52(b)(3)(ii) would permit a card issuer to impose a penalty fee that does not exceed 5% of the dollar amount associated with the violation. The Board is concerned that even when a substantial dollar amount is associated with a violation a penalty fee over a certain dollar amount could exceed the insurer's reasonable and proportional costs of that type of violation and the amount reasonably necessary to deter such violations. The Board noted that Congress did not intend to authorize penalty fees that are significantly higher than those currently charged by credit card issuers.

Comment: *We agree with this proposal.*

3. Application of Proposed 226.52(b) to Charge Card Accounts

A charge card is a credit card for which no periodic rate is used to compute a finance charge. Charge cards are typically products where outstanding balances cannot be carried over from one billing cycle to the next and are payable when the periodic statement is received. Charge card accounts typically require payment of an annual fee, although it is unclear whether these fees are based on the risk. The Board requested information on the methods used by issuers to manage risk with respect to charge cards.

Comment: *No comment.*

IV. Section 226.56 Requirements for Over-the-Limit Transaction Fees

Section 226.56(e)(1)(ii) provides that in the notice informing consumers that their affirmative consent (or opt-in) is required for the card issuer to pay for over-the-limit

transactions, the issuer must also disclose the dollar amount of any fees or charges associated with over-the-limit transactions.

Proposed comment 226.56(e)-1 states that if the amount of an over-the-limit fee varies, such as based on the amount of the over-the-limit transaction, the card issuer may indicate that the consumer may be assessed a fee “up to the maximum” fee.

Comment: *We agree that an issuer should be able to generalize the amount of fees by disclosing the highest rates, provided that a consumer may contact the card issuer or view their account information online.*

V. **Section 226.59 Reevaluation of Rate Increases**

The new Credit Card Act requires that when creditors increase an annual percentage rate applicable to an account that the creditor base such increases on factors including the credit risk of the consumer, market conditions or other factors, and also consider changes in such factors at least once every 6 months to determine whether a rate reduction is warranted. The new law requires that this review include any rates that were increased since January 1, 2009. The new law does not, however, specify the amount of the rate reduction that is required.

The new law also requires creditors to provide 45 days advance notice of such increases and the reasons for the increase.

A. **59(a) General Rule**

Proposed 226.59(a) sets forth the general rule regarding the reevaluation of rate increases by mirroring the statutory language. Under this proposed section, if a card issuer has increased an annual percentage rate since January 1, 2009 based on the credit risk of the consumer, market conditions or other factors, the card issuer must review changes to such factors and, if appropriate, reduce the annual percentage rate applicable to the account. The Board stated that Congress did not intend card issuers to reevaluate rate increases in those circumstances where no advance notice of rate increases is required (e.g., rate increases due to fluctuations in the index for properly disclosed variable rate plan or rate increases due to the expiration of a properly disclosed introductory rate). Accordingly the Board is proposing to limit this requirement to rate increases for which 45 days advance notice is required.

Comment: We agree with this new provision.

Proposed comment 59(a)-1 would clarify that re-evaluations of rate increases apply both to increases in annual percentage rates imposed on a consumer’s account based on circumstances specific to that consumer, such as changes in the consumer’s creditworthiness, and to increases in annual percentage rates due to factors such as changes in market conditions or the issuer’s cost of funds. The Board notes that a card issuer is not required to evaluate the same factors it considered in connection with the

rate increase. Instead, the issuer could review the rate based on the factors it currently uses in determining the annual percentage rate applicable to its accounts.

Proposed comment 59(a)-2 clarifies that a card issuer must re-evaluate its factors for rate determinations only if the increased rate is actually imposed on the consumer's account. If, however, the consumer's actions later trigger application of the penalty rate the card issuer must provide 45 days advance notice and once the penalty rate is applied begin to periodically review and consider factors to determine whether a rate reduction is appropriate. The Credit Card Act also provides protections for consumers against prospective rate increases, including the general prohibition on increasing the rate applicable to an outstanding balance and the 45 day advance notice requirements of 226.59(a)(1).

Comment: *We agree with this comment.*

Proposed Section 226.59(a)(2) would require a card issuer to reduce rates, if applicable, within 30 days after completing a re-evaluation.

Proposed comment 59(a)-3 clarifies how re-evaluations apply to rate increases that occurred between January 1, 2009 and August 22, 2010. For increases which occurred during this period a card issuer must review changes in the factors and reduce the rate as appropriate for those rate increases for which 45 days advance notice would currently be required.

Comment: *We agree with this comment.*

The Board notes that re-evaluating rate increases that occurred prior to the effective date of this rule may impose a substantial burden on card issuers. The Board's proposal, therefore, would permit a card issuer to review, for a brief period of time, either the factors that it used in increasing the rate applicable to the consumer's account or the factors that the card issuer currently uses in determining the annual percentage rates applicable to its credit card accounts.

Comment: *While we agree that a brief transition period is appropriate, we believe that the maximum length of such period should be defined. We would suggest 6 months since this is the same period of time required for general re-evaluations.*

B. 59(b) Policies and Procedures

Proposed 226.59(b) provides that a card issuer must have reasonable written policies and procedures in place to review the factors described in 226.59 it would further require that these policies and procedures be written.

Comment: We agree that such policies and procedures should be written. Additionally, we recommend that such policies and procedures specify how each of these factors were measured and any weight given to one factor or the other.

In particular, we believe that requiring more specification will ensure that re-evaluations are appropriately used.

Proposed comment 59(b)-1 notes that even where a rate reduction is required a card issuer is not required to decrease the rate to the annual percentage rate that was in effect prior to the rate increase giving rise to the obligation to periodically review the consumer's account.

***Comment:** We disagree with this comment. While we acknowledge that changes in the factors may mean that the previous rates are now too low, there need to be protections to ensure that required rate reductions are real in nature. Specifically, there needs to be assurances that reductions aren't merely nominal and accurately reflect the necessary reductions.*

The Board notes that the requirements of proposed 226.59 are different from and operate in addition to the requirements of 226.55(b)(4). Proposed Section 226.55(b)(4) addresses a consumer's right to cure an increased rate, which was a result of a delinquency of more than 60 days, by making the first 6 minimum payments on time after the effective date of the increase. The Board notes that there is a discrepancy between a customer whose rate increased because of payment received 5 days late who cannot reduce this penalty rate by making 6 timely minimum payments, versus a consumer whose account is more than 60 days delinquent and has this right.

The Board explains that this discrepancy exists because, first, a rate increase based on a payment that is 5 days late can only apply to new transactions, whereas a creditor may increase rates on both existing balances and new transactions when a consumer makes a payment that is more than 60 days late. Second, the Board argues that Congress did not specifically state that the cure provisions for delinquencies of less than 60 days also apply to delinquencies of 5 days.

***Comment:** We disagree with this comment. Although Congress did not specifically state that the cure provisions for delinquencies of less than 60 days should also apply to delinquencies of 5 days, it also did not state that they should not apply. It was Congress' intent to ensure that credit card consumers are treated fairly. Allowing such a discrepancy does not further this intent.*

C. 59(c) Timing

Proposed 226.59(c) clarifies the timing requirements for the reevaluation of rate increases.

Specifically, **proposed comment 59(c)-1** would clarify that an issuer has flexibility in determining exactly when to engage in review of its accounts. This comment would provide that an issuer may review all of its accounts at the same time every 6 months, may review each account once each 6 months on a rolling basis based on the date on which the rate was increased for that account, or may otherwise review

such account not less frequently than once every 6 months. **Proposed comment 59(c)-2** provides an example of permissible timing for re-evaluations.

Proposed comment 59(c)-3 clarifies the timing requirement for increases in annual percentage rates on or after January 1, 2009 and prior to August 22, 2010. Specifically, it requires that the first review of such rate increases be conducted within 6 months (e.g., prior to February 22, 2011).

Comment: *We disagree with this comment. Card issuers should be required to review rate hikes as soon as the regulations are effective on August 22, 2010.*

D. 59(d) Factors

Proposed 226.59(d) clarifies that a card issuer could re-evaluate an account based on either the same factors on which the rate increase was originally based or the factors that it currently uses when determining the annual percentage rates for new consumers. The Board believes that competition for new consumers is an incentive that may lead an issuer to lower its rates and if the rates on existing consumers' accounts are assessed using the same factors used for new consumers existing consumers of a card issuer may also benefit from competition in the market.

Comment: *We disagree with this comment. Allowing a card issuer to re-evaluate accounts based on new factors could provide an opportunity for card issuers to exploit consumers. In particular, in order to increase profits a card issuer could simply change its criteria making it much more stringent. By reviewing all of its accounts, under such new criteria it could increase rates dramatically. Thus, credit issuers should be required to review accounts based on pre-existing criteria for the first year after the effective date of this regulation. Thereafter, issuers could change criteria no more than once a year.*

Proposed comment 59(d)-1 clarifies that when a creditor changes the factors it considers in determining the annual percentage rates applicable to its credit card accounts from time to time, it may, for a brief transition period, review the set of factors it considered immediately prior to the change in factors or may consider the new factors.

Comment: *While we agree that a brief transition period is appropriate, we believe that the maximum length of this period should be defined. We would suggest 6 months.*

Proposed comment 59(d)-2 clarifies that the evaluation of existing accounts need not result in such existing accounts being subject to the same rates as those for new accounts, even if a creditor evaluates the same factors for both types of accounts.

Comment: *We agree with this comment.*

Proposed comment 59(d)-3 states that if a card issuer evaluates different factors when determining the applicable annual percentage rates for different types of credit card

plans, it must review whichever factors it considered when determining rates for the consumers' specific type of credit card plan.

Additionally, a card issuer must review the same factors for credit card accounts with similar features and may not consider different factors for each of its individual credit card accounts.

Comment: *We agree with this comment.*

E. 59(e) Rate Increases Subject to 226.55(b)(4)

Proposed 226.59(e) sets forth a special timing rule for evaluations of rate increases that were based on delinquent payments of 60 days. In such circumstances a card issuer is required, pursuant to Section 226.55(b)(4), to reduce the annual percentage rate to the rate that applied prior to the increase if the consumer makes the first 6 consecutive required minimum payments on time. The Board notes that Section 226.55(b)(4) is stronger than the requirement that card issuers review consumers accounts pursuant to 226.59. Specifically, Section 226.55(b)(4)(ii) requires the rate be reduced to the rate that was in effect prior to the rate increase, whereas proposed Section 226.59 does not require that the rate be reduced to the rate that was in effect prior to the rate increase. The Board, therefore, proposes that an issuer should not be required to re-evaluate an account during the first 6 billing periods following a rate increase based on a delinquency of more than 60 days. Instead, if the rate is not reduced after the 6 months because the consumer paid on time during such 6 month period, then the issuer has to re-evaluate the account on 6 month intervals.

Comment: *We agree with this comment.*

F. 59(f) Termination of Obligations to Review Factors

Proposed Section 226.59(f) would state that the obligation to re-evaluate accounts every 6 months does not apply if the issuer reduces the annual percentage rate to a rate equal to or less than the rate immediately prior to the increase. According to the Board, it was not Congress' intent to impose a permanent requirement on card issuers to review changes in factors for a consumer's account even after the annual percentage rate applicable to the account has been reduced to the original rate. The Board notes that if Congress had intended for all card issuers to review the annual percentage rates applicable to all of their accounts indefinitely this would be expressly provided for.

Comment: *We disagree with this comment. Although Congress did not expressly provide for continuous review of all credit card account rates, it also did not specifically state an end date for reviews. The purpose of the Credit Card Act is to protect consumers from, among other things, arbitrary rate increases. Periodic re-evaluations of rates ensure that increased rates are consistently re-evaluated for their appropriateness. Simply because a rate is reduced does not mean that such rate will remain appropriate. Market conditions or changes in the*

consumer's credit score could justify a further rate reduction. Thus, re-evaluations continue to be necessary after a rate has been reduced to its original level. The Board should require a cap on the obligation to review the rate applicable to a consumer's account only when a fixed annual percentage rate at or below 15% of consumers annual income has been reached.

G. 59(g) Acquired Accounts

Proposed Section 226.59(g)(1) sets forth the general rule that the obligation to re-evaluate an account also applies to acquired accounts. A card issuer may review either the factors that the original issuer considered when imposing the rate increase, or may review the factors that the acquiring card issuer currently considers in determining the annual percentage rates applicable to its credit card accounts.

Comment: *We agree with this proposed section.*

Proposed Section 226.59(g)(2) provides an alternate means for re-evaluating acquired accounts. Under this proposal a card issuer would be required to review all of its acquired accounts as soon as reasonably practicable after their acquisition based on the factors that it currently uses to determine the rates applicable to its credit cards. The card issuer would be required to review changes only for those acquired accounts that have rate increases that are imposed as a result of that review. An issuer is not required to review changes in factors for any rate increases made prior to the card issuer's acquisition of such accounts.

The Board believes that this alternative means of compliance is appropriate because card issuers may not have full information regarding rate increases imposed by the prior issuer, when it acquires a new portfolio of accounts. If a card issuer does not know the rate that initially applied to the accounts it acquires It would be required to continue o review the account indefinitely, without the opportunity to cease reviewing until the rate is reduced to the rate that initially applied.

Comment: *We strongly disagree with this proposed section. First, when credit card asset-backed securities are sold consumers generally have no notice of such a sale until after the acquisition. Basing rate increases on the acquirer's factors for determining rates is therefore unfair. The consumer did not apply for a card with the acquirer and should not be subject to new terms without his/her consent. Instead, consumers should be notified of the sale and the new factors that will go into determining whether or not their rate will increase. They should be given a grace period of 6 months to decide whether they want to continue their credit card with the acquirer or terminate the card.*

Second, and more importantly, credit card asset-backed securities are similar in concept to mortgage-backed securities. One of the causes of

the current economic crisis resulted from the sale of mortgage-backed securities. Mortgage-backed securities bundle many mortgages together and sell them to investors. The economic crisis resulted in part from the fact that many of these securities were comprised of bad loans. Since these mortgages were being sold, many of the mortgage companies simply did not care about their financial soundness and rating agencies did not review them thoroughly before rating their soundness. As a result the securities were not worth as much as thought. If, however, the terms of these loans had been carefully reviewed, these facts would have been revealed. The same processes and factors occur with respect to credit card asset-backed securities and the same results will also occur if the buyer does not appropriately examine the riskiness of the underlying credit card accounts, both prior to and after, their acquisition.

As part of their due diligence prior to the acquisition, the acquirer should be required to review the underlying credit card accounts including interest rates. Assuming this is done, an acquirer would have the necessary information needed to re-evaluate a previous rate.

Proposed 59(g)(2) would require a card issuer to review, no less frequently than once every 6 months, the accounts for which the rate has been increased to 20%. The card issuer would not be required to review the accounts subject to 10% and 15% rates pursuant this section unless and until the card issuer makes a subsequent rate increase applicable to those accounts. The Board also states that card issuers should be required to review accounts if a card issuer imposes or continues to impose a penalty rate on an acquired account. The Board also notes that any rate increases the acquiring card issuer makes as a result of its review are subject to the substantive and notice requirements regarding rate increases in Sections 226.9 and 226.55.

Comment: *We disagree with this proposed Section 59(g)(2). The threshold for when acquired accounts must be reviewed should be any rate above 10%. As we have seen, card issuers have raised rates dramatically and rapidly even for those consumers with good credit scores. In many cases rates were raised multiple times within several months without apparent justification. Allowing a card issuer to raise such rates and immediately sell the accounts would be unfair to consumers. Specifically, these account holders would not be able to protest their rate hikes by their previous card issuer and could not have the account reviewed by the acquirer for 6 months. The threshold should therefore much lower.*

H. 59(h) Exceptions

The Board proposed two exceptions to the re-evaluation requirements of Section 226.59. The first exception applies to rate increases imposed after a reduction in rates pursuant to the Service Members Civil Rights Act.

The second proposed exception would apply to charged off accounts. Proposed 59(h)(2) states that review requirements do not apply to accounts that the card issuer had charged off in accordance with loan loss provisions.

Comment: *We agree with this provision.*

VI. Additional Provisions Which Should Be Included

In order to ensure card issuers' compliance with the new regulations, as well as to evaluate the effectiveness of the new regulations, there should be a provision requiring issuers to report the number of rate reductions that occurred following each 6 month review. These results should be made available to the public.

Again, we commend the Federal Reserve for its efforts in issuing the proposed rule as an important step in providing needed consumer protections in financial products and services. We hope that the Board includes these suggested improvements to ensure that these regulations are as effective as possible.

Sincerely,

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